



CITY OF DURHAM | NORTH CAROLINA

Date: May 22, 2012

To: Thomas J. Bonfield, City Manager
Through: Keith Chadwell, Deputy City Manager
From: Reginald J. Johnson, Interim Director
Department of Community Development
Subject: Rebuild Durham, Inc. Substitution of Funds

Executive Summary

Rebuild Durham, Inc. (RDI) currently owns and manages 13 single-family homes which were purchased and rehabilitated between 2000 and 2007 with HUD Home Investment Partnership (HOME) loan funds from the City of Durham. In accordance with HOME regulations, the properties were to be occupied by and remain affordable to households with incomes at or below 60% of the area median for a period of not less than 15 years. Under the HOME regulations, failure to comply with the occupancy requirement during the period of affordability triggers a HUD repayment.

Currently, four of the 13 properties owned by RDI are vacant and not suitable for occupancy. Deficiencies in some of the occupied properties have also been identified. Consequently, the City of Durham is required to substitute non-federal funds for \$366,322.85 which represents the total of RDI's outstanding loan balance. An equal amount of HUD HOME monies will be returned to the City's HOME account.

Recommendation

The Department of Community Development recommends that City Council authorize the expenditure of \$366,322.85 in housing bond program income in the form of a reimbursement to the U.S. Department of Housing and Urban Development.

Background

Under the HOME program, not less than 15% of the entitlement amount must be awarded to Community Housing Development Organizations (CHDOs). For a non-profit to receive a CHDO certification, it must demonstrate that at least one-third of its board composition is comprised of low-to-moderate income persons or persons who live in low-to-moderate income neighborhoods. On a national basis, the CHDO requirement has achieved mixed results. While some CHDOs have established successful track records, many others have failed to complete projects and/or to maintain viable operations. RDI was certified as a CHDO in Durham in the late 1990's.

The first loan to RDI in the amount of \$460,000.00 was approved by Council in August of 2000 to acquire and rehabilitate 12 single-family homes as affordable rental units. At that time, RDI's business plan was to complete the initial 12 properties within 24 months and to complete an additional 15 properties in the third year. By the end of the third year, only 8 units had been acquired and rehabilitated. In August 2003, the loan amount was increased to \$810,000.00 to acquire and rehabilitate a total of 13 properties by a completion date of

August 2005. During 2004 and 2005, four additional properties were acquired before RDI's Executive Director resigned. In the absence of paid staff, one of the RDI board members served in that capacity to keep the properties occupied and all records in compliance with HOME requirements.

When a new Executive Director was hired in May 2006, the City awarded RDI \$20,000.00 in operating grant funds and subsequently, the completion date for the final unit was extended again. In March 2007, the Department of Community Development arranged for RDI to attend capacity building training at HUD's Greensboro office.

In April 2007, RDI was awarded a \$24,000.00 operating grant and \$138,000.00 in acquisition/rehabilitation funds in an effort to allow the organization to continue working towards its initial goal of 27 properties. In July 2007, the final unit under the original contract was completed.

While RDI drew down the operating grant awarded them in 2007, it did not expend any of the additional monies awarded them to acquire and rehabilitate properties. The completion date for the additional properties was extended initially to May 2008 and then to December 2008. During the term of the final extension, the Executive Director that had been hired in 2007 was terminated and board members assumed responsibility for the day-to-day operations of the organization.

In December 2008, RDI became delinquent in the payment of its City loans and the organization was notified of the 60-day delinquency. The required HOME rental monitoring found code violations in some of the units and inadequate file documentation as required by the HOME program.

Throughout the first half of 2009, Community Development staff met with RDI board members to review compliance requirements and provide technical assistance. While loan payments were brought current, issues with compliance continued. Formal written notice of failure to comply with HOME requirements and the terms of the City's loan was issued in October 2009.

In December 2009, Community Development staff met with the entire board and strongly recommended to RDI that it consider divesting itself of its portfolio either by selling properties on the open market and paying off the first mortgages and the City's second mortgages, or by conveying them to another non-profit with significant property management experience. An alternative recommendation offered by the staff was to contract with a property manager experienced in managing federally-funded rental units. The decision of the board was to request proposals from property management firms.

In 2010, RDI reported that it had not been able to find a property management firm interested in its portfolio of properties and in October of that year, hired a part-time Executive Director. Community Development staff met with the Executive Director within 30 days to provide technical assistance with regard to HOME compliance requirements.

When formal monitoring was conducted in March 2011, five of the 13 properties were vacant and RDI indicated that it did not have the resources required to repair the units to make them suitable for occupancy. Subsequently, the Department scheduled a consultation with HUD to assess options for dealing with non-compliance. Based on a review of the records and an exterior inspection of the vacant units, it was apparent to HUD staff that the project failed to

meet the affordability requirements for the period specified and the City should assess its options to remedy the non-compliance.

HOME rules allow for repaid HOME funds to be returned to the locality's HOME account provided that the funds were not drawn from fiscal years where recapture provisions apply. In the case of RDI, there were expenditures from fiscal years where the funds would not be returned to the local HOME account unless a written waiver was approved by HUD. That approve waiver was signed on March 30, 2012.

Issues and Analysis

Eleven of the 13 properties owned by RDI have first mortgages held by SunTrust. Because of the high vacancy rate, RDI requested a loan modification from SunTrust to enable it to become current on first mortgage loan payments and to improve cash flow to provide a source of funding to make repairs to the vacant units and get them re-occupied. SunTrust has extended a loan modification agreement to RDI that would have the effect of cutting monthly principal and interest payments in half. The sum of the first mortgage loans held by SunTrust is approximately \$425,000.00.

RDI has not made loan payments to the City since September 2011 and based on a review of its rental income and expenses, RDI would have limited ability to resume loan payments even if all units were occupied. The Department's recommendation is to enter into new deferred loan agreements with RDI. With a deferred loan, the City's existing loan balances would remain, with no payments and no forgiveness provision, for the remaining loan term. As properties are sold, the City would remain in second position behind SunTrust on eleven of the properties to receive a pay-off from the sales proceeds. The City would remain in first position on a twelfth property. The offer to enter into deferred loans is subject to RDI agreeing to deed the thirteenth property (110 Chestnut Street) to another non-profit acceptable to the City. The Chestnut Street property is located in Southside.

Working in consultation with the City Attorney's office, the Department will prepare deferred loan documents for Council consideration after the July 2012 break.

To assist RDI in sustaining itself until the substitution of funding has been completed, the Department has provided it with an \$8,000.00 emergency operating grant using housing bond program income.

Alternatives

HUD has been aware of RDI's struggles for the past several years and the City's efforts to provide assistance. The proposed payback and program restructuring are voluntary actions by the City with HUD's knowledge. Should these voluntary actions not be taken, HUD would ultimately issue a formal request for the payback of the HOME investment.

In terms of other courses of action, the Department of Community Development did consider providing funds to RDI to rehabilitate its portfolio. However, such an investment (potentially as much as \$600,000.00) would be a short term fix to current physical deficiencies and would not address the longer term issues of regulatory compliance and the sustainability of an organization dependent on rental income from only 13 properties.

The Department also assessed the option of having RDI transfer ownership of the properties to another non-profit. This option would require the consent of both SunTrust and RDI. Given the condition of the properties and the current occupancy status, assuming ownership

of the portfolio by another non-profit would not be an attractive business deal without the same loan deferral being recommended for RDI and perhaps other assistance from the City as well.

Having the City seize ownership of the properties is yet another option. However, this option would require the City to pay off the existing SunTrust first mortgage loans.

Financial Impact

Housing bond program income is available as the payback source. As noted previously, the City has received a waiver from HUD that will allow the payback amount to be returned to its HOME account.

SDBE Summary

Not applicable to this item.